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Intelligence Report

Mrs. Gandhi's New Economic Program

Confidential
ER IR 75-20
October 1975

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Mrs. Gandhi's New Economic Program

By announcing a new 20 Point economic program one week after declaring a state of emergency, Mrs. Gandhi has tied her political future closely to India's future economic performance. She has picked an opportune time to do so because the best monsoon in five years will provide a near-record harvest this year. Industry will also receive short-term benefit from increased hydroelectric power and abundant agricultural raw materials. More rapid industrial growth, however, will increase demand for oil. Newly discovered offshore fields cannot be developed rapidly enough to keep oil imports from rising. Since a significant cut in imports is unlikely, New Delhi will continue to rely heavily on foreign assistance, debt rescheduling, and IMF borrowings to finance its large current account deficit.

Long-run economic growth, however, depends on

- slowing rapid growth of population,
- lessening agricultural dependence on the vagaries of the annual monsoon,
- loosening of industrial controls that have discouraged investment in the private sector,
- reducing dependence on imports for two-thirds of petroleum consumption, and

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Note: Comments and queries regarding this report are welcomed. They may be directed to [redacted] of the Office of Economic Research, [redacted]

- reversing the growing balance-of-payments deficit and foreign debt burden.

The 20 Point program does not attack these problems. Without major policy changes, the long-run outlook mirrors the recent past:

- imports of foodgrains will -- on the average -- remain large;

- petroleum imports will continue to be a heavy burden; and

- New Delhi will annually seek ever increasing foreign subsidies, as well as debt rescheduling.

DISCUSSION

Introduction

1. One week after assuming near-dictatorial powers in June, Prime Minister Gandhi announced a sweeping 20 Point economic program. Although largely a restatement of earlier promises, Mrs. Gandhi's new authority gives her more power to implement changes. Mrs. Gandhi's theme is that India can now get on with economic development because the obstructionists have been removed. Thus, her political future has become closely linked to India's future economic performance.

2. The main economic objectives of the 20 Point program are to reduce the prices of essential commodities, expand agricultural and industrial production, and improve the position of the rural poor. Specific measures include

- renewed efforts against hoarders, blackmarketeers, and smugglers;
- expansion of irrigated acreage by 5 million hectares;
- addition of 2,600 megawatts to electric power capacity;
- liberalization of investment controls;
- enforcement of rural land holding ceilings and distribution of surplus land to landless laborers;
- a moratorium on small farmers' debt payments; and
- abolition of bonded labor.

Background

3. Since FY 1971,[1] India's burgeoning population has exceeded economic growth (see Figure 1 and the Table) with the result that living

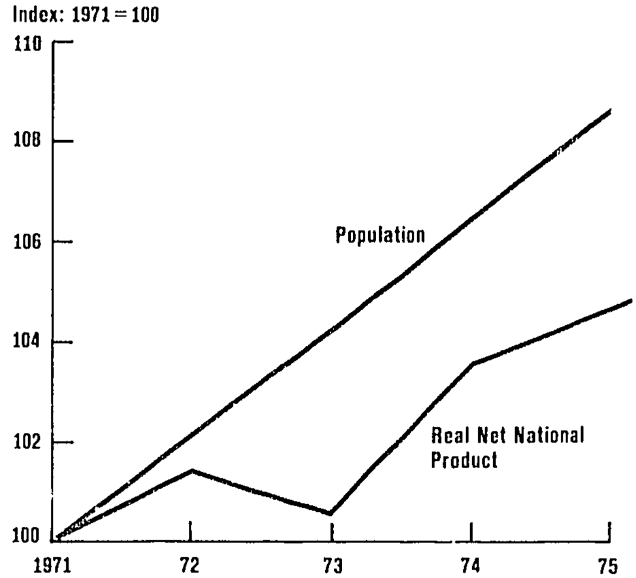
1. Indian fiscal year ends on 31 March of the stated year.

standards have declined. By the government's own reckoning, almost half its people live at a subsistence level. More than 80% of the population lives in half a million villages, engaged for the most part in primitive, labor-intensive agriculture.

4. Indian economic policies have been essentially socialistic. For nearly a quarter century the government has tried to develop an industrial, self-sufficient economy

Figure 1

INDIA: Population and Real Net National Product



Note: The Indian fiscal year ends on 31 March of stated year.
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India: Population
and Real Net National Product

Fiscal Year[1]	Population (Million Persons)	Real Net National Product[2] (Million US $)
1971	550.8	2,538
1972	562.5	2,573
1973	574.2	2,551
1974	586.1	2,630
1975	598.4	2,656

1. The Indian fiscal year ends on 31 March of the stated year.
2. In FY 1961 prices, converted at the rate of 7.5 Rupees to US $1.

through comprehensive state economic planning, selective nationalization of private enterprises, and extensive bureaucratic controls on private industry. Import growth has been constrained and industrial self-sufficiency enhanced, but at high cost in overall productivity. Indian export and industrial growth rates have significantly lagged behind those of other advanced LDCs. Natural resources remain underutilized.

Areas of Major Concern

Population

5. According to official statistics, India's population reached 600 million this year. Growing at about 2.1% annually, the population is increasing by 12 million a year. This high rate of increase is expected to decline little during the next decade because reduced infant mortality through improved sanitation and medicine has markedly increased the proportion of women of childbearing age.

6. Two decades of government-sponsored birth control programs have had little effect. New Delhi estimates that births prevented through 20 years of birth control programs total less than 13 million, or about 2% of its current population. Government support for these programs is now declining because of the increasing priority of other programs such as energy and industrial development. Budgetary allocations for family planning have dropped since their FY 1973 peak. Family planning goals have been continuously undermined by central government provision of tax, land, and welfare advantages to large families. Family planning has been conspicuously absent from the flurry of statements since the emergency declaration.

Agriculture

7. India is one of the world's major producers of grains, peanuts, tea, jute, cotton, and sugar cane. Although most agricultural production is

consumed domestically, agricultural commodities contribute — directly or indirectly — about 70% of export earnings.

8. Indian agriculture is critically dependent on the timing and intensity of the summer monsoon rains, which provide 75% of annual rainfall. About three-fourths of annual agricultural production — including two-thirds of total foodgrains — is normally grown during the summer season. Rice, India's principal grain crop, is the main summer crop, and wheat is the major winter crop.

9. Following a record crop year 1971[2] harvest of 108 million metric tons, foodgrain production has averaged only 102 million tons annually because of adverse weather and ill-advised government controls on the grain trade. Grain imports, which declined steadily from a high of 10 million tons in 1972, are again rising.

10. Grain production in CY 1975 was low — 102 million tons — because of subnormal summer rains in many key areas. With little grain in reserve (on the order of 2.5 million tons), 6 million tons of foodgrain were purchased to supplement domestically procured grain for the subsidized distribution system centered in urban areas. More than 4 million tons was purchased through commercial channels from the United States, thereby making India the largest customer of US wheat in the last crop year. India also received 800,000 tons of US wheat under PL-480. The 1975 summer monsoon was the best in five years and should produce a good fall harvest. Nevertheless, India is expected to import 4-5 million tons of foodgrains this crop year. Nearly 3.5 million tons have already been bought for delivery after 1 July, including 2.4 million tons of US wheat.

11. The division of responsibility for the formulation and implementation of agricultural policy between the central government and the states has also contributed to a disappointing performance. While the central

2. The Indian crop year ends on 30 June of the stated year.

government establishes national agricultural policies and budgets, three-quarters of total public expenditues on agriculture are controlled by the states and reflect regional rather than central priorities.

12. Agricultural growth also has been hindered by inconsistent central government policies. Following an agricultural crisis, agriculture is given priority, but after a few good harvests, resources are reduced, agricultural programs are shunted aside, and long-term projects are postponed. Long-term production increases are targeted but not vigorously pursued. Despite continuing claims that agriculture is a priority sector, the portion of investment allocated to agriculture was reduced in the FY 1976 Annual Plan released in late July.

13. New Delhi will continue to need foodgrain imports during the next three to five years. Consecutive monsoon failures, as occurred in the mid-1960s, could push grain import requirements to 10 million tons or more in any one year. A prolonged period of favorable weather like that of the late 1960s might give India a temporary respite from the burden of massive grain imports. Without a major reorientation of agricultural policies, however, periods of improved foodgrain production and reduced imports will persist only until the next poor monsoon.

14. The impact of the 20 Points on agricultural production will be mixed. More rapid expansion of irrigation, more energy for irrigation pumps, and increased investment in the fertilizer industry will increase production. On the other hand, a vigorous effort to enforce land holding ceilings and to redistribute land could disrupt the rural economy. The moratorium on small farmers' debt will tend to reduce output by sharply curtailing rural credit from money lenders before other institutions will be able to take up the slack. The 20 Points also fail to alter grain trade restrictions that inhibit production incentives. Although Mrs. Gandhi has more power since the emergency declaration to force the states into closer compliance with central government objectives for agriculture, she has moved slowly because more precipitous action would alienate important elements in her Congress

Party. In sum, agricultural production will increase in CY 1976, primarily because of good monsoon rains and only marginally as the result of Mrs. Gandhi's new powers.

Industry

15. National economic planners have given priority to industrial development, with basic heavy industry reserved for the public sector. Expansion of private sector industry is controlled through restrictive licensing of industrial construction and imports, as well as broad-spectrum price controls. Private foreign investment is restricted to those industries requiring massive investment or extensive foreign technology. The principal export industries remain predominantly in private hands. However, they have been taxed heavily to help finance public investment.

16. These policies have led to basic imbalances in the industrial structure and sluggish industrial growth. Industrial output grew by less than 1% in 1973 because of the cumulative impact of bottlenecks in such key industries as steel, nonferrous metals, coal, and petroleum. The industrial slowdown continued into 1974 as New Delhi undertook restrictive monetary policies and curtailed public sector investment outlays to combat a 30% annual inflation rate.

17. Economic growth has accelerated recently because of the loosening of controls on the most severely affected industries and a sharp fall in the rate of inflation. Businessmen are optimistic for several other reasons:

- by tying her political future to better economic performance, business believes, Mrs. Gandhi must try to stimulate industrial production;

- Mrs. Gandhi's 20 Point program liberalized investment and import controls while avoiding further nationalization; and

- in July, Mrs. Gandhi forced union leaders to agree to a moratorium on all strikes.

The growing trade deficit, however, may force the government to restore or extend import controls even before industrial growth can react to the recent liberalization.

Energy Resources

18. India is relatively well endowed with energy resources, but exploitation of these resources has lagged. About half of the country's energy consumption comes from noncommercial fuels, such as firewood and dung. Coal accounts for about 60% of energy consumption of commercial fuels, petroleum for 25%, and hydroelectric and nuclear power for 15%. Coal reserves exceed 100 billion tons, some 1,300 times current annual production. In contrast, proved petroleum reserves (excluding recent offshore discoveries) of 750 million barrels are only 15 times current annual production.

19. Current petroleum output of about 140,000 barrels per day (b/d) covered only one-third of India's petroleum consumption in FY 1974. Oil output from currently producing fields is slowly declining. The financial strain of the sharp increase in world petroleum prices prompted New Delhi to impose a ceiling on petroleum imports. This ceiling held imports at the FY 1974 level, but their cost doubled.

20. Offshore oil exploration shows considerable promise, but it will not make a significant contribution to energy resources for several years. Tentative evaluation of five successful test wells in the Bombay High indicates that the field may have an ultimate potential of more than 200,000 b/d. A recent Indian estimate claims that this potential output could be reached by 1980. A more realistic projection would be 50,000 b/d in view of the worldwide shortage of drilling crews, rigs, and associated equipment, as well as Indian restrictions on foreign investment. Mrs. Gandhi can do little

more to stimulate oil exploration without inviting in foreign oil companies on a large scale, which she is unlikely to do. If annual petroleum consumption growth can be held to 5% and domestic oil production increased from the current 140,000 b/d to 200,000 b/d by 1980 — optimistic assumptions — India will still have to import two-thirds of its petroleum consumption.

International Payments and Debt[3]

21. India's balance of trade has deteriorated dramatically during the last two years. In FY 1973 India had its first trade surplus in 22 years. During the next two years, a 61% growth in exports was dwarfed by a 128% growth in imports, and the trade deficit rose to a record $1.4 billion. Outlays on three of India's most essential imports — petroleum, foodgrains, and fertilizer (see the tabulation) -- accounted for the increase. Expenditures on other imports essential to industrial production were held at FY 1973 levels, but quantities were generally lower. Exports also benefited from soaring

	Million US $		
	FY 1973	FY 1974	FY 1975[1]
Balance of trade	140	-510	-1,390
Exports	2,550	3,220	4,100
Imports	2,410	3,730	5,490
Selected imports			
Foodgrains	110	600	1,300
Petroleum	270	700	1,400
Fertilizer	130	280	670

1. Provisional.

3. Trade data exclude military imports from the USSR and Eastern Europe, which amount to 2%-4% of total imports.

world market prices, especially for sugar. Declining domestic demand, progressive depreciation of the rupee -- which until September 1975 was tied to the pound sterling -- and positive steps by New Delhi to promote exports were also important.

22. New Delhi is accelerating its shift from import substitution to export promotion. Since the emergency, export licensing has continued to be simplified, more credit has been made available to exporters, and special import entitlements have been granted exporters. Imports, however, remain strictly controlled.

23. The government remains committed to reducing the concentration of private economic power and dependence on foreign firms. Private foreign investment is allowed only if it earns foreign exchange through exports, saves foreign exchange through import substitution, or transfers advanced technology to India. The interest of potential foreign investors, in turn, is cooled by New Delhi's limitation of foreign equity to 40% in most enterprises and by the extensive state controls of supplies, trade, personnel, and expansion that severely curb management flexibility. These policies have not changed since the emergency, and New Delhi shows no signs of making a serious effort to attract private foreign investment.

24. The deterioration in the trade balance over the past two years caused a massive increase in net foreign borrowing after several years of decline (see Figure 2). India obtained nearly $700 million from the International Monetary Fund (IMF) and obtained the following estimated amounts of aid:

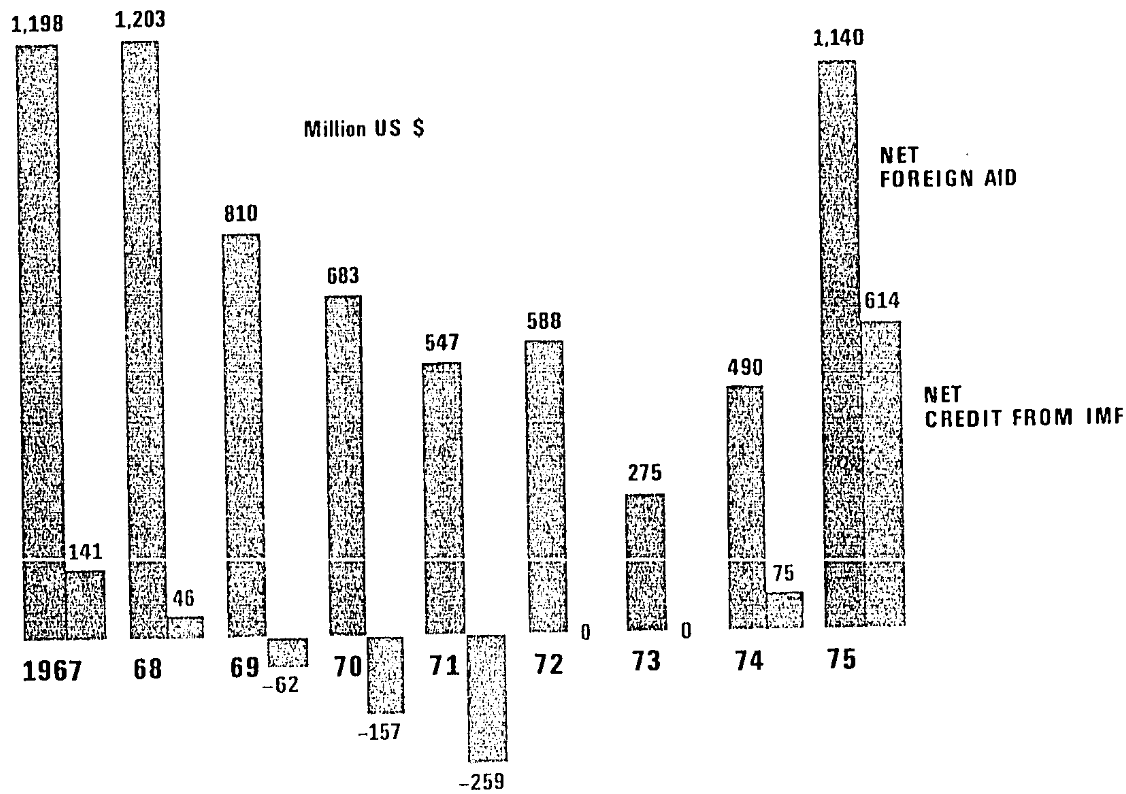
	Million US $[1]	
	FY 1974	FY 1975
Aid to India Consortium		
Disbursements	890	1,130
Debt rescheduling	180	200
Soviet wheat loan	90	240
Iranian and Iraqi oil offsets	....	210

	Million US $[1]	
	FY 1974	FY 1975
Other	20	110
Total, gross	1,180	1,890
Debt service	690	750
Total, net	490	1,140

1. Excluding military aid.

Figure 2

INDIA: Net Foreign Aid and IMF Credits



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The United States has made no new project assistance commitment since December 1971. During FY 1975, however, Washington has rescheduled $45 million in debts, provided $78 million worth of grains under PL-480, and donated $6 million worth of commodities through relief agencies. The United States also agreed to ship $128 million worth of wheat under PL-480 to arrive in FY 1976.

25. In FY 1976 the level of global aid will probably remain close to last year's. In June the consortium pledged almost $1.8 billion, but authorizations may be less because member countries have their own balance-of-payments problems. Iran agreed to a $150 million oil credit this year and more may be forthcoming from Iraq. The USSR and Eastern Europe have viewed Mrs. Gandhi's emergency measures positively, but they remain unresponsive to Indian efforts to soften loan terms or reschedule debts and are unlikely to increase aid significantly. New Delhi recently borrowed an additional $241 million from the IMF Oil Facility.

26. India will press vigorously for further debt rescheduling as its debt service payments grow. New Delhi has obtained debt relief annually for the last nine years and was annoyed when a few consortium members, including the United States, refused to participate this year. In FY 1976 the debt service obligation was $760 million before debt rescheduling and will increase to around $900 million by FY 1979. In addition, repayment for much of India's 1974 borrowing from the IMF will also fall due during this period. Thus, India's ability to meet payments will continue to hinge largely on the new loans and repeated rescheduling of payments.

Outlook

27. The short-term outlook for the Indian economy is guardedly optimistic. This summer's monsoon will temporarily lift the Indian economy from the stagnation of the past two years. Foodgrain imports will decline marginally. Increased supplies of agricultural raw materials and electric power will stimulate industry. A widespread pickup in economic activity would also increase the need for imported petroleum to meet a rising demand for energy. The 20 Point program will have little effect on India's short-term economic outlook. The program does not address the central economic problems of low domestic savings and investment, industrial and agricultural disincentives, aid dependency, and large external debts. Those measures that would have the most profound long-term impact, such as land reform, will be the hardest to implement.

28. In the long run, no lasting improvement in Indian living standards is foreseen so long as the Indian economy remains tightly bound to the performance of the monsoon. The bond could be loosened – but not severed – by increased investment allocations to agriculture. Mrs. Gandhi, however, appears satisfied that her present investment priorities are basically correct. New Delhi's emphasis on income redistribution instead of growth and use of strict control of transactions rather than market incentives also will discourage sustained economic growth.

29. Prospective production will barely exceed population growth. New Delhi will annually request increasing aid from foreign donors and press for continuing debt rescheduling. Unless more fundamental changes than those covered in the 20 Point program occur in government policies, the Indian economy will continue to stagger along, sustained by the uncertain benevolence of the monsoons and the more reliable international dole.